FILED
JAN 8 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 727

FRANK J. LORENZ,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Sixth Circuit
and
BRIEF IN SUPPORT THEREOF

MARION A. ROSS,
314 Hartman Theatre Building,
Columbus, Ohio,
Attorney for Petitioner.

LESLIE WEAVER PUBLISHERS, CINCINNATI, OHIO

INDEX

PAGES

PETITION FOR WRIT OF CERTIORARI 1-12

Opinions of the Court Below 1

Jurisdictional Grounds 2

Statutes and Regulations Involved 2

Questions Presented 2

Statement 3

Reasons for Granting Writ 6

Conclusion 10

APPENDIX

Internal Revenue Code

Section 22 (a) 11

Section 181 11

Section 182 (c) 11

Section 3797 (a) (2) 11

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI 13-25

Orders or Judgments of the Courts Below 13

Jurisdiction 13

Statutes and Regulations Involved 14

Statement of the Case 14

Specification of Error 15

Argument 15

Summary of Argument 15

Point I. Did the Petitioner Exercise Good Faith in Forming a Bona Fide Partnership with His Wife? 17

PAGE

Point II. Did the Petitioner Make a Gift to His Wife Relinquishing Control of a One-half Interest in The Lorenz Equipment Company? 17

Point III. Local Law Controls in Determining the Status or a Relationship Made Expressly Subject to Federal Taxation 19

Point IV. The Tax Court's Decision "Is Not in Accordance with Law" and the Decision of the Circuit Court of Appeals Affirming it Should Be Reversed 23

Conclusion 24

CASES CITED

PAGES

Blair v. Commissioner, 300 U. S. 5 ..... 8, 21, 23

Commissioner v. Scottish American Company, 323 U. S. 119, 1924 22

Dobson v. Commissioner, 320 U. S. 49 ..... 8, 23

Edson v. Lucas, 40 Fed. 2nd, 398 16

Erie Railroad Company v. Tompkins, 304 U. S. 67, 78 .. 6

Helvering v. Fuller, 310 U. S. 69, 74 21

Helvering v. Stuart, 317 U. S. 154, 161, 87 L. Ed. 154 .. 7, 21

Lorenz v. Lorenz, Common Pleas Court, Franklin County, Ohio, Case No. 163,783 (see entry and order of the Court, Record, 211.) 20

Lusthaus v. Commissioner of Internal Revenue, 149 Fed. 2nd, 232 9

Morgan v. Commissioner, 309 U. S. 78-82 ..... 7, 21

Poe v. Seaborn, 282 U. S. 101, 110 ..... 6, 20

Francis E. Tower v. Commissioner of Internal Revenue, 148 Fed. 2nd, 388 8

Trust U/W Mary Lily (Flager) Bingham et al. v. Commissioner, ... U. S., ..., 89 L. Ed. 8, 23

OTHER CITATIONS

Mertens Law of Federal Taxation, Vol. 10, Sections 61.09 and 61.11 7

STATUTES CITED

Ohio General Code, Section 799, Partnerships 19

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

FRANK J. LORENZ,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Sixth Circuit

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Frank J. Lorenz, petitioner above, respectfully petitions your Honorable Court that a writ of certiorari issue to review the decision and order of the United States Circuit Court of Appeals for the Sixth Circuit, entered April 13, 1945, petition for rehearing denied October 15, 1945, affirming a decision of the Tax Court of the United States entered May 8, 1944, in favor of the respondent and against the petitioner.

OPINIONS BELOW

The instant case originated with the filing of a petition (Record 3 and Record 14) for a rehearing on a deficiency found by the Commissioner of Internal Revenue (R. 6) in the Tax Court of the United States, which Court entered its decision on May 8, 1944 (R. 35). Printed

Record Pages 22 to 32 and reported in 3 T. C. 746, affirming the action of the Commissioner, and holding that "the petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all of the economic incidents of ownership." (R. 32). Five judges dissenting. (R. 33).

A petition for review from the decision of the Tax Court was filed in the United States Circuit Court of Appeals for the Sixth Circuit (R. 36) which Court affirmed the decision of the Tax Court without a written opinion (R. 219).

JURISDICTION

The decision of the Circuit Court of Appeals for the Sixth Circuit was entered on April 13, 1945 (R. 219). A petition for rehearing was filed May 3, 1945, rehearing was denied by the Court on October 15, 1945 (R. 233). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (Sec. 347 of Title 28 U. S. C. A.).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations here involved may be found in the Appendix, infra, pages 11 to 12.

QUESTIONS PRESENTED

This case involves the interpretation of the Internal Revenue Laws in connection with a husband and wife partnership and in which the following questions are presented.

1. Is the partnership between taxpayer petitioner herein and his wife one which should be recognized for federal income tax purposes?

2. Is the state and local law governing the ownership of property and the right to income therefrom to apply in the interpretation and application of the federal revenue laws?

3. Can the Tax Court of the United States, through a decision based upon its conclusions of fact, attribute income from property to the petitioner, the ownership of which has been previously decided and determined to be the property and income of another by a contested declaratory judgment action in an Ohio State Court of Record, the State Court having jurisdiction and having previously determined the status of the parties, the ownership of the property, and the right to income from said property?

4. Did the United States Circuit Court of Appeals for the Sixth Circuit err in sustaining the Tax Court's decision herein in taxing the petitioner with the entire earnings of the partnership under Section 22 (a) of the Revenue Act of 1938 and under the Internal Revenue Code?

STATEMENT

The general facts in these proceedings are not in dispute. However, the decision of law based on the ultimate conclusions of facts as found by the Tax Court of the United States are not concurred in by the Petitioner.

On January 10, 1940, Frank J. Lorenz and Isabel M. Lorenz entered into and signed a written agreement of co-partnership, to be effective January 1, 1940, to operate the business of The Lorenz Equipment Company. (Exhibit 1, R. 201, R. 103 and R. 70.)

Prior to the entering into of the above agreement, the petitioner, Frank J. Lorenz, on January 1, 1940, by an outright gift, upon which a gift tax return was duly made and filed, (Exhibit 8, R. 100), gave to Isabel M. Lorenz,

his wife, a one-half interest in The Lorenz Equipment Company (R. 105, 106 and 139), which interest was valued at $20,000.00, thereby releasing all control over the subject matter of the gift and the income to be derived from the gift, the gift itself consisting of tangible assets. (R. 107, 108.)

The petitioner contributed to the partnership, as his share of the capital, the one-half interest which he had retained and Isabel M. Lorenz contributed, as her share of the partnership, the one-half interest which had been given to her by her husband. A capital account was set up on the books of that company reflecting such ownership (R. 73, 75, 76 and Exhibits 2, 3, 4, and 17.) The earnings of the partnership thereafter were allocated to the respective partners under the terms of the partnership agreement. The books of the partnership were kept accordingly and funds were withdrawn from the partnership for Isabel M. Lorenz, (Exhibits 3, and 4, R. 74, 75, 77, 82 and 88.)

The Lorenz Equipment Company was known to be operated as a partnership during the year 1940 by persons and companies having occasion to do business with it (R. 60, 63, 68, 71, 72, 122, 151 and 152.)

Credit was extended to The Lorenz Equipment Company in the year 1940 on the basis that said company was a partnership, consisting of two individuals, Isabel M. Lorenz and Frank J. Lorenz. (R. 124, 152 and Exhibit 12.)

Policies, investments and the management of the company were conducted by both the petitioner and Isabel M. Lorenz, his wife, during the year 1940, according to the terms of the written partnership agreement entered into between the parties. Isabel M. Lorenz spent about two

full days of each week throughout the year at the company's place of business. (R. 78, 159, 160, 185, 189, 191 and 192.)

Funds were withdrawn from The Lorenz Equipment Company for Isabel M. Lorenz during the year 1940, which funds represented her share of the earnings and the return on her investment in the company, and at the close of business for the year 1940, distribution was made on the books of the company to the credit of Isabel M. Lorenz in the amount of one-half of the assets, profits and earnings of the company. (R. 73, 74, 75, 77, 80, 82, 83, 188 and Exhibits 2, 3, 4, 5, 6, 7, 8 and 13.)

Findings of the Tax Court (R. 24), were that the partnership enterprise had gross assets used in the business of approximately $44,000.00 and that these assets for the most part consisted of tangible items such as equipment, parts and machinery. During the year in question there were eight employees of The Lorenz Equipment Company. Further, during 1940, the gross profit of the business was as follows: (R. 27) Profit on sales—$37,322.80; Commission on direct sales—$3,480.50; General Machinery Income—$13,647.09; Shop Income—$608.71. These facts are important in proving that the partnership employed a very substantial capital in the production of its income and that this case is distinguishable from a family partnership where the earnings result from the individual efforts of the husband. (Exhibit 13, R. 103, 130, 131, 132, 133 and 140.)

Isabel M. Lorenz, as a partner in The Lorenz Equipment Company, brought an action, as plaintiff, against Frank J. Lorenz, this petitioner as a contesting defendant, said case being known as No. 163,783 in the Common Pleas Court of Franklin County, Ohio, in which she

secured a declaratory judgment and a final order on March 16, 1943, which order reaffirmed her right to keep and control one-half of the assets, proceeds and earnings of The Lorenz Equipment Company. (R. 205 and 213.)

Notwithstanding the foregoing facts, the Tax Court concluded (R. 32), "that the petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all of the economic incidents of ownership thereof," citing *Francis E. Tower*, which case is now pending in this Court on writ of certiorari, number 317; and that, therefore, the "petitioner's wife did not make any actual contribution to the capital of the partnership."

The Circuit Court of Appeals for the Sixth Circuit sustained the above decision of the Tax Court, without opinion, although the same Circuit Court of Appeals held exactly opposite in the *Tower* case cited above.

REASONS FOR GRANTING THE WRIT

1. Aside from the importance of the question herein involved as affecting State Courts, and their power to construe and determine local issues, we submit that the decision of the Tax Court of the United States and the decision of the Circuit Court of Appeals for the Sixth Circuit, were clearly erroneous and not in accord with the applicable decisions of this Court which have announced and adhered to the principle that in the application of the Federal Revenue Act, State law controls in the determination of the nature of the legal interests which the taxpayer has in property, and the income sought to be reached by the Statute.

See *Poe* v. *Seaborn*, 282 U. S. 101; *Erie Railroad Com-*

pany v. *Tompkins*, 304 U. S. 67, at page 78; *Morgan* v. *Commissioner*, 309 U. S. 78, at page 82; *Helvering* v. *Stuart*, 317 U. S. 154, at page 161.

The decision of the Tax Court of the United States, which decision the Circuit Court of Appeals affirmed, states "it is concluded that the petitioner did not make a bona fide gift of a one-half interest in the business of The Lorenz Equipment Company because of his failure to divest himself of all the economic incidents of ownership thereof", and that "it follows that petitioner's wife did not make any actual contribution to the capital of the partnership."

The foregoing decision, which was subject to a strong dissent in the Tax Court, is based on a clear cut mistake of law in that the Tax Court and the Circuit Court of Appeals for the Sixth Circuit both failed to apply the law as announced by this Court in the above cited cases and, further, failed to apply the "Supreme Court's rule of distinction." (See Mertens Law of Federal Income Taxation, Vol. 10, Section 61.09 and 61.11.)

> "When the will of Congress depends upon a fact which can be interpreted only according to a state rule of property, as upon the question whether title was passed under state law, the state rule will govern."

In addition to the uncontradicted facts, the record shows that Isabel M. Lorenz exercised full control over her one-half interest in the partnership and that both the control and the right to control the assets of the company, and the decision as to who were the owners of the assets, all are questions of local law which had been previously decided by the Ohio State Court of Record. (See final order and entry R. 211 and 212.)

The above facts and the law cited fit squarely into the case of *Blair* v. *Commissioner*, 300 U. S. 5, where the Court held in the opinion

> "2d. The question of the validity of the assignments is a question of local law. The donor was a resident of Illinois and his disposition of the property in that State was subject to its law."

2. The Circuit Court of Appeals in affirming the decision of the Tax Court of the United States has decided an important question of federal law in direct conflict with the established principles announced by this Court, that the existence of a relationship or of a legal interest in property as established by local law and by common law rules of property must be recognized in the application of the Federal Revenue Act. In so doing it has departed from the principles laid down by this Court in *Dobson* v. *Commissioner*, 320 U. S. 489 and *Trust U/W of Bingham* v. *Commissioner*, decided June 4, 1945 to the effect that (a) "clear cut mistake of law made by the Tax Court requires its reversal."

The error of the Tax Court of the United States and the error of the Circuit Court of Appeals lies in their failure to distinguish between (1) those cases where taxpayers undertake to allocate or assign income to a person who does not produce that income, and (2) those cases where, according to a state rule of property, a legal interest has been created in favor of a taxpayer who has the right to enjoy the property or the legal interest therein and the income from said property.

3. The decision of the United States Circuit Court of Appeals for the Sixth Circuit is in direct conflict with the decision of the same Court in the case of *Commissioner of Internal Revenue* v. *Francis E. Tower*, 148 F. 2nd, 388,

which is now pending upon a writ of certiorari in this case, known as No. 317.

4. Family partnerships, especially those involving husband and wife, have been adopted by hundreds of taxpayers all over the United States. The aftermath of the formation of these partnerships has been a flood of litigation both before the Tax Court and before Federal Courts, which has resulted in the fact that the Commissioner of Internal Revenue, the taxpayers and their counsels have no definite rule from this Court pertaining to the questions raised.

There is now pending before this Court not only the Tower case cited above, but also the *Lusthaus Case No.* 263, both cases having been admitted on writ of certiorari. However, the instant case varies from the two aforementioned cases in that here we have not only the record but the fact that an Ohio State Court of Record has decided and decreed who were the owners of the property and who had the income from that property as a matter of local law.

It is important in the administration of the Revenue Acts, both to the Treasury Department and to the Taxpayers that the conflicts cited in the above cases, and discussed herein, should be clarified to the end that some degree of uniformity may be adopted by all concerned. This matter has been the subject of wide comment.*

---

* American Bar Association Journal, "Family Partnerships," page 322, June, 1945.

Commerce Clearing House 1945 Rewrite Bulletin, No. 27, paragraph 8414, May 9, 1945.

Ibid., No. 28, paragraph 8420, June 27, 1945.

Estate and Tax News, Reprint of "That Family Partnership Quarrel," page 552, June, 1945 (material copyright Prentice Hall, Inc.)

George Washington Law Review, "The Partnership in Tax Avoidance," by Randolph Paul, page ....., February, 1945, condensed digest in Taxes, page 552, June, 1945.

Prentice Hall, Current Commentary Report, No. 23, paragraph 70526.

In the interest of brevity, petitioner does not at this time set forth all of the points which will be urged at the argument or the merits of this case should the writ be granted, nor all of the conditions in support of such points, but petitioner herein refers to and incorporates into this petition all of the matters presented in its assignment of errors contained in the supporting brief filed herewith, as if fully set out herein.

CONCLUSION

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out and under the seal of this honorable court directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding said Court to certify and send to this Court a full and complete transcription of the record and proceedings of the said United States Circuit Court of Appeals for the Sixth Circuit in Case No. 9871 and known as Frank J. Lorenz, petitioner, v. Commissioner of Internal Revenue, respondent, to the end that this case may be reviewed and determined by this Court as provided by the statutes of the United States; and that the decisions and judgment of said United States Circuit Court of Appeals for the Sixth Circuit be reviewed and reversed by this Honorable Court; and for the petitioner to have such further relief as to this Court may seem proper.

Respectfully submitted,

MARION A. ROSS,
Attorney for Petitioner.

December 28, 1945.